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SYNOPSES

STUDYING BORROWER LEVEL RISK CHARACTERISTICS OF EDUCATION LOAN IN INDIA

Arindam BANDYOPADHYAY

The main objective of this paper is to study the performance of education loans over time and identify key risk factors of such loans across various geographies and constitutions. Using borrower level data of 5000 borrowers, from four major public sector banks in India, this paper empirically examines how education loan defaults and losses are explained by various characteristics associated with the loan (loan amount, interest rate, repayment period) and security positions (such as margin given and security). Various borrower characteristics such as age, marital status, presence of guarantor or co-borrowers also have been examined. A set of univariate statistical tests as well as multivariate logit and Tobit regression techniques have been used to find out the answers. The empirical findings suggest that borrower defaults on education loan payments are mainly influenced by security, borrower margin and repayment periods. Borrowers with security cover are 1.5 times more likely to remain solvent than those without securities. A 10 percent increase in borrower margin (BMARGIN) decreases the odds of default (PD/PS) by 9.18 percent. The presence of a guarantor or co-borrower and collateral security significantly increases the chances of loan recovery and hence reduces default loss rates. Moreover, the socioeconomic characteristics of borrowers and their regional locations also act as important factors associated with education loan defaults. The paper suggests that strengthening borrower risk assessment techniques, portfolio monitoring, due diligence in lending, and institute performance measures can reduce credit risk in education loans. Merit, employability, and reputation of institutions should matter in loan appraisal to reduce the default risk.

SUBORDINATE DEBT, DEPOSIT INSURANCE AND MARKET ORIENTED MONITORING OF BANKS

Gaurav Singh CHAUHAN and Satyam S. SUNDARAM

The paper presents a model of a bank with endogenous risk choices, where delegated monitoring by subordinate debt helps to contain risk shifting by banks in the presence of deposit insurance. While there are individual shortcomings in these instruments, their joint featuring to stabilise banks is deemed complementary in this paper. While deposit insurance can increase welfare for uninformed depositors and helps in averting information based bank runs, active monitoring by subordinate debt can counter moral hazard associated with deposit insurance. The model developed here explores conditions which can lead banks to choose the risk consistent with the risk chosen by a social planner as first best.

The model builds on previous studies and envisages an active market for subordinate debt which can continuously impart signals to the regulators and other at-risk stakeholders. This provides the necessary discipline for banks so that they may conform to solvency consistent behaviour. While active monitoring is a precondition to achieve the first best, it can be ensured by inducing stronger interest on part of subordinate debt holders to monitor bank risk. A market in these securities, therefore, is deemed vital which further enables the incorporation of the risk assessment by subordinate debt into the objective functions of banks.

The model also depicts the relevance of subordinate debt in eliminating the distortions in deposit insurance pricing. Specifically, subordinate debt helps in checking the risk shifting incentives even when the insurer charges a premium other than the first best, while completely eliminating these incentives where optimal quantities of subordinate debt are chosen. Importantly, the paper also argues that subordinate debt can induce incentives for counter-cyclical asset allocation by banks for their risky portfolios.